



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Number: 201004043
Release Date: 1/29/2010

Date: 11/4/2009

UIL: 501.03-02

Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

Legend:

M =
A =
B =
C =
D =

Dear :

This is in reply to your letter of November 13, 2008, concerning the federal income and excise tax consequences under section 507 and certain sections of Chapter 42 of the Internal Revenue Code (Code) relating to a proposed partial transfer of assets, in the manner and for the purposes described below.

Facts

You are exempt from federal income tax pursuant to section 501(c)(3) of the Code and are classified as a private foundation within the meaning of section 509(a). M is exempt from federal income tax pursuant to section 501(c)(3) and is classified as a private foundation within the meaning of section 509(a). Your trustees are C and D; whom are related parties. The directors of M are A, B, and C; all of whom are siblings.

By mutual agreement M's three directors have agreed to divide its assets and to transfer one-third of its principal and accrued income thereof to your organization. M will retain two-thirds of its remaining principal and accrued income and continue to be managed by A and B. C will resign as one of M's directors; however, C will remain as one of your Trustees. The transfer of M's assets to you will allow your trustees to manage the transferred assets pursuant to your governing instrument.

You and M represent that to the best of your collective knowledge, neither Foundation has committed either a willful repeated acts (or failures to act) or a willful and flagrant act (or failure to act) giving rise to liability for tax under Chapter 42 of the Code. Both foundations represent that no distribution of their assets will be made until the rulings requested herein are granted.

Rulings Requested

You have requested the following rulings:

1. M's transfer, without consideration, of its assets, equal to approximately one-third of its total value, to you will constitute a significant distribution of assets to one or more private foundations within the meaning of section 1.507-3(c)(1) of the Income Tax Regulations ("regulations") and, therefore, as a transfer described in section 507(b)(2) of the Code, will not be subject to tax under section 507(c).
2. M's transfer to you will not result in termination of your private foundation status under section 507(a) of the Code but, instead, will constitute a reorganization between those private foundations under section 507(b)(2).
3. M's transfer to you will not constitute notification of your intent to terminate your private foundation status under section 507(a)(1) of the Code, or any willful repeated acts (or failures to act) or any willful and flagrant act (or failure to act) under section 507(a)(2) by you. Thus, you will not be liable for any tax imposed by section 507(c).
4. Pursuant to section 507(b)(2) of the Code, you will not be treated as a newly-created organization.
5. You will be treated as possessing your tax attributes and characteristics pursuant to section 1.507-3(a)(2), (3), and (4) of the regulations.
6. M's transfer to you will not give rise to any net investment income or constitute any other taxable sale or disposition under section 4940 of the Code.
7. M's transfer to you will not constitute any act of self-dealing under section 4941 of the Code by M, you or any of their foundation managers as defined in section 4946.
8. Upon M's transfer to you, you will succeed to a portion of your excess qualifying distributions under section 4942 of the Code, if any, based upon your proportionate share of M's total assets received.
9. M's transfer to you will not constitute taxable expenditures under section 4945 of the Code.
10. M will not be required to exercise any expenditure responsibility under section 4945(h) of the Code with respect to your M of assets to you.
11. Pursuant to section 1.507-3(a)(9) of the regulations, and for purposes of chapter 42 and sections 507 through 509 of the Code, you will be treated as if you were M in the proportion that the fair market value of M's assets (less encumbrances) transferred to you bears to the fair market value of M's assets (less encumbrances) immediately before the transfer of M's assets.

Law:

Section 501(c)(3) of the Code provides an exemption from federal tax for organizations that are organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 507(a)(1) of the Code states that a private foundation may voluntarily terminate its private foundation status by submitting to the Internal Revenue Service a statement of its intention to voluntarily terminate its private foundation status pursuant to section 507(a)(1) and by paying any termination tax under section 507(c).

Section 507(b)(2) of the Code states that when one private foundation transfers assets to one or more other private foundations, each transferee private foundation shall not be treated as a newly created organization.

Section 507(c) of the Code imposes an excise tax equal to the lower of: (1) the aggregate tax benefits that have resulted from the private foundation's exempt status under section 501(c)(3), or (2) the value of the net assets of the private foundation on an organization that voluntarily terminates its private foundation status.

Section 4940(a) of the Code imposes an annual tax on the net investment income of private foundations.

Section 4940(c) of the Code defines net investment income as the amount by which the sum of the gross investment income and the capital gain net income exceeds the deductions allowed by paragraph (3).

Section 4941(a) of the Code imposes an excise tax on acts of self-dealing between a private foundation and any of its disqualified persons as defined in section 4946.

Section 4942(a) of the Code imposes on the undistributed income of a private foundation for any taxable year, which has not been distributed before the first day of the second (or any succeeding) taxable year following such taxable year (if such first day falls within the taxable period), a tax equal to 30 percent of the amount of such income remaining undistributed at the beginning of such second (or succeeding) taxable year.

Section 4942(g)(3) of the Code states that, for purposes of this section, the term "qualifying distribution" includes a contribution to a section 501(c)(3) organization described in paragraph (1)(A)(ii) if (A) not later than the close of the first taxable year after its taxable year in which such contribution is received, such organization makes a distribution (within the meaning of paragraph (1) or (2), without regard to this paragraph) which is treated under subsection (h) as a distribution out of corpus (or would be so treated if such section 501(c)(3) organization were a private foundation which is not an operating foundation), and (B) the private foundation making the contribution obtains adequate records or other sufficient evidence from such organization showing that the qualifying distribution described in subparagraph (A) has been made by such organization.

Section 4945(a) of the Code imposes a tax on the taxable expenditures of a private foundation.

Section 4945(d)(4) of the Code states, in part, that for purposes of this section, the term "taxable expenditure" means any amount paid or incurred by a private foundation as a grant to an organization unless such organization is described in paragraph (1) or (2) of section 509(a), is an organization described in section 509(a)(3), or is an exempt operating foundation, or the private foundation exercises expenditure responsibility with respect to such grant in accordance with subsection (h).

Section 4945(h) of the Code defines the term "expenditure responsibility" to mean that a private foundation is responsible to exert all reasonable efforts and to establish adequate procedures to see that the grant is spent solely for the purpose for which made, to obtain full and complete reports from the grantee on how the funds are spent, and to make full and detailed reports with respect to such expenditures to the Secretary.

Section 1.507-3(a)(1) of the Treasury Regulations (regulations) states that in the case of a significant disposition of assets to one or more private foundations, within the meaning of paragraph (c) which describes a section 507(b)(2) of the Code transfer, the transferee organization shall not be treated as a newly created organization, but shall succeed to those attributes and characteristics of the transferor organization described in section 1.507-3(a)(2), (3), and (4), which include its aggregate tax benefit, substantial contributors, and chapter 42 tax and penalty liabilities.

Section 1.507-3(a)(2) of the regulations states, in part, that a transferee organization to which this paragraph applies shall succeed to the aggregate tax benefit of the transferor organization.

Section 1.507-3(a)(3) of the regulations states that, for purposes of section 507(d)(2), in the event of a transfer of assets described in section 507(b)(2), any person who is a "substantial contributor" (within the meaning of section 507(d)(2)) with respect to the transferor foundation will be treated as a "substantial contributor" with respect to the transferee foundation, regardless of whether such person meets the \$5,000-two percent test with respect to the transferee organization at any time.

Section 1.507-3(a)(4) of the regulations states that if a private foundation incurs a liability for one or more of the taxes imposed under chapter 42 (or any penalty resulting therefrom) prior to, or as a result of, making a transfer of assets described in section 507(b)(2) to one or more private foundations, in any case where transferee liability applies, each transferee foundation shall be treated as receiving the transferred assets subject to such liability to the extent that the transferor foundation does not satisfy such liability.

Section 1.507-3(a)(5) of the regulations states that, except as provided in subparagraph (9) of this paragraph, a private foundation is required to meet the distribution requirements of section 4942 for any taxable year in which it makes a section 507(b)(2) transfer of all or part of its net assets to another private foundation.

Section 1.507-3(a)(6) of the regulations provides that when a private foundation makes a section 507(b)(2) transfer of all or part of its net assets to another private foundation, the applicable

period of time described in section 4943(c)(4), (5), or (6) shall include both the period during which the transferor foundation held such assets and the period during which the transferee foundation holds such assets.

Section 1.507-3(a)(8)(ii) sets forth certain rules that apply to the transferee foundation with respect to the assets transferred in a section 507(b)(2) transfer to the same extent and in the same manner that they would have applied to the transferor foundation had the 507(b)(2) transfer not been effected, mostly in the nature of transitional rules of limited scope for the Tax Reform Act of 1969.

Section 1.507-3(a)(9)(i) of the regulations provides that if a private foundation transfers all of its net assets to one or more private foundations which are effectively controlled (within the meaning of Sec. 1.482-1(a)(3)), directly or indirectly, by the same person or persons which effectively controlled the transferor private foundation, for purposes of chapter 42 (section 4940 et seq.) and part II of subchapter F of chapter 1 of the Code (sections 507 through 509) such a transferee private foundation shall be treated as if it were the transferor.

Section 1.507-3(c)(1) of the regulations states that a transfer of assets is described in section 507(b)(2) if it is made by a private foundation to another private foundation pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization.

Section 1.507-3(c)(2) of the regulations defines the term "significant disposition of assets to one or more private foundations" as any disposition or series of dispositions where the cumulative total of dispositions is 25 percent or more of the fair market value of the net assets of the foundation at the beginning of the taxable year.

Section 1.507-4(b) of the regulations states that private foundations which make transfers described in section 507(b)(2) are not subject to the tax imposed under section 507(c) with respect to such transfers unless the provisions of section 507(a) become applicable.

Section 53.4945-5(c)(2) of the Foundation Regulations (foundation regulations) provides that, with regard to capital endowment grants made to private foundations, if a private foundation makes a grant to another private foundation for endowment or for other capital purposes, the grantor foundation must require reports from the grantee foundation on the uses of the principal and the income (if any) from the grant funds. The grantee must make such reports annually for the tax year in which the grant was made and for the immediately succeeding two tax years. Only if it is reasonably apparent to the grantor, before the end of such grantee's second succeeding tax year, that neither the principal nor the income from the grant funds has been used for any purpose which would result in liability for tax under section 4945(d) of the Code, may the grantor then allow the grantee's reports to be discontinued.

Section 53.4946-1(a)(8) of the foundation regulations states that, for purposes of section 4941 of the Code only, the term "disqualified person" shall not include any organization which is described in section 501(c)(3) (other than an organization described in section 509(a)(4)).

Analysis:

Ruling 1:

Section 507(b)(2) of the Code describes a transfer from one private foundation to another private foundation according to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization. Section 1.507-3(c)(1) of the regulations describes the terms "other adjustment, organization, or reorganization" as including any partial liquidation or any other significant distribution of assets to one or more private foundations, other than transfers for full and adequate consideration or distributions out of current income. The term "significant disposition of assets to one or more private foundations" is defined by section 1.507-3(c)(2) as any disposition or series of dispositions where the aggregate value transferred is 25 percent or more of the fair market value of the net assets of the foundation at the beginning of the taxable year. Since M is transferring more than 25 percent of the fair market value of its net assets to you, a private foundation, for no consideration, the proposed transfer is a significant disposition of assets that qualifies as a transfer under section 507(b)(2).

Rulings 2 and 3:

Pursuant to section 1.507-4(b) of the regulations, a private foundation that makes a transfer described in section 507(b)(2) of the Code is not subject to the tax imposed under section 507(c) with respect to such transfer unless the provisions of section 507(a) become applicable. As discussed in Ruling 1 above, your transfer will constitute a significant distribution of assets described in section 507(b)(2). You have stated that you have not and will not notify the Secretary of your intent to terminate your status as a private foundation and that you have not ever either committed willful repeated acts (or failures to act) or committed a willful and flagrant act (or failure to act) which gives rise to tax under chapter 42 of the Code. Therefore, M proposed transfer of assets to you under section 507(b)(2) will not terminate N's private foundation status under section 507(a) and does not result in a termination tax imposed by section 507(c).

Ruling 4:

When a private foundation makes a transfer described in section 507(b)(2) of the Code, the transferee foundation is not treated as a newly created organization under section 1.507-3(a)(1) of the regulations. Since your transfer is described in section 507(b)(2), as discussed in Ruling 1 above, you will not be treated as a newly created organization.

Ruling 5:

In the case of a significant disposition of assets to one or more private foundations within the meaning of section 507(b)(2) of the Code, the transferee organization shall be treated as possessing those attributes and characteristics of the transferor organization which are described in subparagraphs (2), (3), and (4) of section 1.507-3(a) of the regulations. As discussed in Ruling 1 above, your transfer is described in section 507(b)(2). Accordingly, you will be treated as possessing your attributes and characteristics as described in sections 1.507-3(a)(2), (3), and (4) of the regulations.

Ruling 6:

Section 4940(c) of the Code imposes an excise tax on investment income received by private foundations. Investment income includes capital gains from the sale or other disposition of property. The transfer of assets by M to you, which lacks consideration, does not constitute a "sale or other disposition of property" that would generate capital gains subject to excise tax under section 4940. Therefore, the transfer will not be treated as a taxable sale or disposition of property within the meaning of section 4940.

Ruling 7:

Section 4941(a) of the Code imposes an excise tax on each act of self-dealing between a disqualified person and a private foundation. Sections 4941 and 1.507-3(a) of the regulations determine whether the proposed transfer of part of M's assets to you will constitute an act of self-dealing between a private foundation and its disqualified persons, as defined in section 4946. Under section 53.4946-1(a)(8) of the foundation regulations, a "disqualified person" does not include organizations that are exempt under section 501(c)(3). Therefore, M's transfer of assets to you is not an act of self-dealing because you are recognized by the Service as an organization exempt from tax under section 501(c)(3).

Ruling 8 and 11:

Under section 1.507-3(a)(9)(i) of the regulations, if a private foundation transfers all of its net assets to another private foundation which is effectively controlled by the same person or persons which effectively controlled the transferor private foundation, the transferee private foundation is treated as if it were the transferor. Here, M transferring less than all of its net assets to you, so you are not treated as M for all private foundation purposes. Instead, you will be treated as possessing M's attributes and characteristics which are described in sections 1.507-3(a)(2), (3), (4), and, to the extent applicable, (6) and (8)(ii), and none of M's excess qualifying distribution carryovers under section 4942 will transfer to you.

Under section 1.507-3(a)(5) of the regulations, except as provided in subparagraph (9) of section 1.507-3(a), a private foundation must meet the distribution requirements of section 4942 of the Code for any taxable year in which it makes a section 507(b)(2) transfer of all or part of its net assets to another private foundation. The transfer itself shall be counted toward satisfaction of such requirements to the extent the amount transferred meets the requirements of section 4942(g)(3), which states that the term "qualifying distribution" includes a contribution to a section 501(c)(3) organization if the redistribution requirements are met. Therefore, your proposed transfer shall be counted toward the satisfaction of your distribution requirements to the extent the amount transferred meets the redistribution requirements of section 4942(g)(3).

Rulings 9 and 10:

M's section 507(b)(2) transfer of assets to you is a grant to you for capital endowment purposes. Because you are not treated as M under section 1.507-3(a)(9), the transfer is a taxable expenditure under section 4945(d)(4) of the Code unless you comply with the expenditure

responsibility requirements of section 4945(h). M's transfer to you will not be considered a taxable expenditure as long as you exercise expenditure responsibility over the transfer in accordance with sections 4945(h) and section 53.4945-5(c)(2) of the foundation regulations. Section 53.4945-5(c)(2) requires the grantee to make annual reports for the year in which the grant is made and the immediately succeeding two years.

Conclusion:

Based on the foregoing, we rule as follows:

1. M's transfer, without consideration, of assets equal to approximately one-third of your total value to you will constitute a significant distribution of assets to one or more private foundations within the meaning of section 1.507-3(c)(1) of the regulations and, therefore, as a transfer described in section 507(b)(2) of the Code, will not be subject to tax under section 507(c).
2. M's transfer to you will not result in termination of your private foundation status under section 507(a) of the Code but, instead, will constitute a reorganization between those private foundations under section 507(b)(2).
3. M's transfer to you will not constitute notification of your intent to terminate your private foundation status under section 507(a)(1) of the Code, or any willful repeated acts (or failures to act) or any willful and flagrant act (or failure to act) under section 507(a)(2) by you. Thus, you will not be liable for any tax imposed by section 507(c).
4. Pursuant to section 507(b)(2) of the Code, you will not be treated as a newly-created organization.
5. You will be treated as possessing your tax attributes and characteristics as described in section 1.507-3(a)(2), (3), and (4) of the regulations.
6. M's transfer to you will not give rise to any net investment income or constitute any other taxable sale or disposition under section 4940 of the Code.
7. M's transfer to you will not constitute any act of self-dealing under section 4941 of the Code by M, you or any of their foundation managers as defined in section 4946.
8. M's transfer to you, you will not succeed to any of your excess qualifying distributions under section 4942 of the Code.
9. M's transfer to you will not constitute a taxable expenditure as long as you follow the expenditure responsibility requirements of section 4945(h) of the Code and section 53.4945-5 of the foundation regulations with respect to capital endowment grants.
10. M will be required to exercise expenditure responsibility with respect to the transferred assets under section 4945(h) of the Code and section 53.4945-5 of the foundation regulations with respect to capital endowment grants.

11. You will be treated as possessing M's tax attributes prior to the transfer only to the extent provided in section 1.507-3(a)(2), (3), (4), (6) and 8(ii) of the regulations.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. A copy of this letter should be kept in your permanent records.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Acting Manager, Exempt Organizations
Technical Group 3